No. 15,049

United States Court of Appeals

For the Ninth Circuit

HONOLULU OIL CORPORATION,
a corporation,
Appellant,

vs.

KATHARINE H. KENNEDY and MARK C. ELWORTHY, Executors of the Will of Frank Kennedy, Deceased,
Appellees.

Appeal from the District Court of the United States for the Northern District of California, Southern Division.

APPELLANT'S REPLY BRIEF.

HERBERT W. CLARK,
Crocker Building, San Francisco 4, California,
Attorney for Appellant Honolulu Oil Corporation.

Of Counsel:
MORRISON, FOERSTER, HOLLOWAY, SHUMAN & CLARK,
A. L. GIBSON,
H. M. DOWNS.
Crocker Building, San Francisco 4, California,

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INTRODUCTION.

Appellees in their brief urge that the judgment of the court below should be sustained upon two principal grounds: First, that this court should not examine the evidence in the case, consisting entirely of a Statement of Agreed Facts and documentary exhibits thereto, but rather is bound by the usual rule that a reviewing court will not, in the face of conflicting evidence, disturb the Findings of Fact or Conclusions of Law of the trial court. Appellees' second point, stated in various ways throughout their brief, in sum amounts only to the contention that either a joint adventure, a cotenancy, or some other general fiduciary relationship existed between the parties which prevented the running of the statute of limitations. We shall take up in order the various points presented.

POINT ONE.

THIS COURT HAS NOT ONLY THE RIGHT BUT THE DUTY TO DRAW ITS OWN INFERENCES AND CONCLUSIONS FROM THE STATEMENT OF AGREED FACTS AND DOCUMENTARY EXHIBITS THERETO, AND IS NOT BOUND BY THE DETERMINATION OF THE LOWER COURT.

Appellees urge that this court should follow the general rule "that an appellate court will not disturb the findings of fact of the trial court." Yet they admit on page 3 of their brief that whether or not a fiduciary duty existed between the parties is a question of fact to be determined from the *documents* defining the respective interests of the parties.

The principle invoked by appellees is only applicable where a trial court has heard testimony, formed its conclusion as to the credibility of the witnesses, and drawn inferences and conclusions from the evidence. In such a case, the reviewing court will not retry the facts.

But this is not a case in which any witness was heard; there is no evidence other than the facts admitted by the pleadings, agreed to in the Statement of Agreed Facts, or disclosed by the documents attached thereto as exhibits.

It is well settled that an appellate court may make its own inferences and draw its own conclusions from undisputed or stipulated facts or purely documentary evidence. As this court has stated in *Pacific Portland Cement Co. v. Food Mach. and Chem. Corp.*, 178 F.2d 541 (9th Cir. 1949) at page 548:

> ". . . we may make our own inferences from undisputed facts or purely documentary evidence."

The distinction between a case dependent upon the testimony of witnesses and one in which all the evidence rests upon documents or stipulated facts is well discussed in the case of *Tipton v. Bearl Sprott Co.*, 93 F.Supp. 496 (S.D. Cal. 1950). Here the court said at page 498:

> "It is the accepted rule that where a case is presented on stipulated facts, the mandate of Fed. Rules Civ. Proc. Rule 52, 28 U.S.C.A., that 'findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses' does not come into play. In short, when there are no witnesses, and the Court draws inferences from agreed facts, then the presumption of the correctness of the trial court's findings does not apply. The Courts have so held repeatedly, and have not hesitated to draw different legal conclusions from admitted facts."

Thus, in this case, this court has the power and the duty to draw its own inferences and conclusions from the stipulated facts and documents thereto.

Gillette's Estate v. Commissioner of Internal Rev., 182 F.2d 1010 (9th Cir. 1950);

American Eagle Fire Ins. Co. v. Eagle Star Ins. Co., 216 F.2d 176 (9th Cir. 1954);

McGah v. Commissioner of Internal Revenue, 210 F.2d 769 (9th Cir. 1954);

Eddy v. Prudence Bonds Corporation, 165 F.2d 157 (2nd Cir. 1947);

Wigginton v. Order of United Commercial Travelers, 126 F.2d 659 (7th Cir. 1942).

As stated in the *Wigginton* case (at p. 661):

> "Since the facts are not in dispute, we are free to consider them and to reach our own conclusion, untrammeled by the District Court's findings and conclusions of law. Especially is this rule applicable in the case at bar, where all the facts are stipulated."

POINT TWO.

THE APPELLEES HAVE FAILED TO DEMONSTRATE ANY RELATIONSHIP OF COTENANCY, COADVENTURE, CONFIDENTIAL RELATIONSHIP, FIDUCIARY RELATIONSHIP OR ANY OTHER RELATIONSHIP OF TRUST AND CONFIDENCE, WHICH WOULD TOLL THE STATUTE OF LIMITATIONS.

A. The fact that the pertinent documents were executed on or about the same day has no bearing on the relationship of the parties.

Appellees argue that, because the pertinent documents here involved were all executed at the same time, they constituted "an integrated plan" for the development of all the lands embraced therein, and that if a relationship of cotenancy existed between the parties as to the "Kennedy fee lands," such relationship necessarily existed as to the "Kennedy lease lands." Appellees significantly have not cited any authorities in support of this startling proposition. In effect, it amounts to an assertion that the rights and obligations —as well as the status—of the parties to an instrument affecting one parcel of land are altered by an instrument executed on the same day as to another parcel of land. Thus, if A and B entered into an agreement of cotenancy as to Blackacre, and if on the same day A leased Whiteacre to B for a period of 5 years, the appellees would have us to believe that a relationship of cotenancy as to both Blackacre and Whiteacre was created. Such a rule would introduce confusion and uncertainty into the field of property law.

An analogous case which is directly against the appellees' contention is *Newell v. McMillan,* 139 Kan. 94, 30 P.2d 126 (1934). In that case certain lessors under oil and gas leases were attempting to enforce a $100 statutory penalty on five separate leases which were executed as one general transaction. It was urged that because the five separate leases were all a part of the same transaction, a separate penalty on each lease could not be collected. The court held that each lease must be considered as a separate and independent contract, saying at pages 131-2 (of 30 P.2d):

> "Five separate instruments leasing the separate tracts of land were executed and separately recorded. Each instrument evidenced a complete and independent contract."

In short, the Kennedy fee lands and the Kennedy lease lands were handled by the parties as totally distinct parcels, the parties having separate and independent rights and duties as to each parcel. That the parties intended no "integrated plan" is apparent from the fact that, although Kennedy consented to the inclusion of the lease lands in the Kettleman North Dome Agreement, he never consented to the inclusion therein of that portion of the Kennedy fee lands involved in this litigation. (Tr. 55)

Appellees' argument that an "integrated plan" resulted in a cotenancy or created a fiduciary relationship is neither founded upon the facts disclosed by the record nor upon any known principle of law.

B. The appellees have failed to demonstrate that the parties to this action have a fiduciary relationship which operates to toll the statute of limitations.

The primary case relied upon by appellees is *Taylor v. Odell,* 50 C.A.2d 115, 122 P.2d 919 (1942), but an examination of the decision reveals that in reality it is authority for the appellant's position. The facts of the case were that Odell, the defendant, orally asigned to Taylor, the plaintiff, an overriding royalty interest. Subsequently Odell leased the well to the Two-and-One Oil Company. For almost two years, Taylor received royalties, but after April 20, 1935, Two-and-One arbitrarily discontinued payment. Taylor did not commence his action until three years and two months after the parol agreement was repudiated. Thus a crucial question before the court was whether the suit was barred by Section 339 of the Code of Civil Procedure, which imposes a two-year statute of limitations upon actions founded on oral agreement, or whether the period of limitation was governed by Section 343, which provides a four-year period as to actions for relief not otherwise provided for in the code.

The court held that Section 343 was applicable, and used language indicating that a trust relationship existed between the parties. (See 50 C.A.2d at 123-4). The opinion and the decisions on which it relies disclose that the court was speaking of a *constructive trust* relationship as a form of equitable relief.

See,

Hannah v. Canty, 175 Cal. 763, 167 Pac. 373 (1917);

Schiffman v. Richfield Oil Co., 8 C.2d 211 at 227, 64 P.2d 1081 (1937);

La Laguna Ranch Co. v. Dodge, 18 C.2d 132, 114 P.2d 351 (1941);

Dougherty v. California Kettleman Oil Royalties, 9 C.2d 58, 69 P.2d 155 (1937).

The actual holding of the case is that, although the agreement concerning royalties was oral, the suit was essentially an action to impose a constructive trust and was governed by the four-year statute of limitations applicable to action for relief not otherwise provided for in the code.

The court did not have before it, and did not discuss, the problem in the case at bar as to whether there was such a fiduciary relationship between the parties as would *toll the statute of limitations.* Where a fiduciary duty arises out of a *substantive* relationship such as beneficiary and trustee of an express trust, partnership, principal and agent, guardian and ward, etc., the statute does not run so long as the fiduciary duty is not openly repudiated. However, the imposition of a *constructive trust,* which is a *remedial* device, does not thereby establish a fiduciary relationship which acts to toll the statute of limitations. It is well established in California that in the case of a constructive trust the statute begins to run at once upon the doing of acts by reason of which the trust arises, no repudiation being necessary to set the statute in motion.

> *Norton v. Bassett,* 154 Cal. 411, 97 Pac. 894 (1908);
>
> *Broder v. Conklin,* 121 Cal. 282, 53 Pac. 699 (1898);
>
> *Benoist v. Benoist,* 178 Cal. 234, 172 Pac. 1109 (1918);
>
> *Lezinsky v. Mason Malt W.D. Co.,* 185 Cal. 240, 196 Pac. 884 (1921);
>
> *Earhart v. Churchill Co.,* 169 Cal. 728, 147 Pac. 942 (1915).

In other words, even if this court should find that Honolulu Oil Corporation or its predecessors in interest were constructive trustees as to the Kennedy royalty rights, there is, nevertheless, no fiduciary relationship such as will toll the running of the statute of limitations.

Actually, the case of *Taylor v. Odell* is authority for appellant. The court in that case (50 Cal.App.2d at page 124) clearly indicated that the statute of limitations started to run on the date the Two-and-One Oil Company refused to pay royalties. The court did not find a fiduciary relationship such as would toll the statute of limitations. Indeed, if there had been such a relationship, it would have been unnecessary for the court to discuss the problem whether the two-year or four-year statute of limitations was applicable. The only reason the plaintiff prevailed in that case was that he commenced the action within four years after the nonpayment.

As to the case of *Heaston & Glimpse v. West American Oil Company,* 44 C.A.2d 107, 111 P.2d 905 (1941), cited on page 11 of appellees' brief, no more need be said than that the parties in that action had *agreed* that their substantive relationship was one of principal and agent, and was therefore fiduciary in nature. As stated by the court at page 110 (of 44 C.A.2d):

> "Appellant and respondent *agreed* that the contractual relationship the parties bore to each other was that of *principal* and *agent.* By the terms of the agreement * * * the appellant, who was the agent of the respondent, was obligated, *as a trustee,* to pay * * * until respondent's claim had been paid in full." (Emphasis supplied)

The record does not disclose the terms of the agreement creating the agency in that case nor does it indicate the extrinsic agreements which may have caused the parties to stipulate that a fiduciary relationship existed. Inasmuch as the existence or non-existence of a fiduciary relationship was not argued before the court, the decision furnishes no authority for appellees' broad proposition that in California an operating lessee is a trustee for the payment of assigned royalties. As the California Supreme Court has emphasized in

Maguire v. Hibernia S. & L. Soc., 23 Cal.2d 719, 146 P.2d 673 (1944), cases are not authority for propositions not argued and considered by the court.

Thus, the decisions cited by appellees do not support their position as to the vital question in this case, that is, whether any cotenancy, coadventure, or other fiduciary relationship existed between the parties which would toll the statute of limitations.

Appellees concede on page 14 of their brief that the usual, ordinary, every-day assignments, leases and operating agreements create no cotenancy, coadventure or other fiduciary relationship between the parties thereto. However, they urge that the agreements in this case involve "something more" than usual, ordinary, every-day assignments of an oil and gas lease. This "something more" is variously ascribed to covenants running with the land, to an alleged promise by Honolulu or its predecessors to acknowledge Kennedy's royalty interest in the event of extensions, modifications and renewals of the lease, and to the existence of a real property interest *in perpetuity* held by Kennedy and his successors. We shall examine each of these points in order.

C. Covenants running with the land do not create a fiduciary relationship.

On page 13 of their brief, appellees assert that covenants running with the land create a fiduciary relationship. In support of this statement three cases are cited. The first, *McClure v. Colyear,* 80 Cal. 378, 22 Pac. 175 (1889), involved a mother who breached her fiduciary duty to her children by taking funds belonging to them and investing in property which was purchased in the name of her second husband. There was no discussion of covenants running with the land. The second case, *Heaston & Glimpse v. West American Oil Co.,* 44 C.A.2d 107, 111 P.2d 905 (1941), concerned a breach of trust between principal and agent who admitted their fiduciary relationship. Again covenants running with the land were not even remotely connected with the case and were not discussed by the court. In *Berniker v. Berniker,* 30 C.2d 439, 182 P.2d 557 (1947), the case involved a resulting trust, which arose when the father-in-law of plaintiff received funds belonging to her. Covenants running with the land were not mentioned in the decision.

Inasmuch as these cases are irrelevant, a brief examination of covenants running with the land is in order. Judge Charles E. Clark, in his famous study, *Real Covenants and Other Interests which "Run with Land,"* notes that the problem of covenants running with the land is one of rationalization or justification of the transfer of essentially contractual obligations to strangers. (See 2d edition, pages 1 through 5 and 209.)

See:

Reno, *Covenants, Rents and Public Rights,* II American Law of Property, Part 9, Section 9.1;

Holdsworth, *A History of English Law,* Vol. VII, pp. 287-292;

5 Restatement, Property, Introductory Note, pp. 3147-3161 (1944).

The distinguishing feature of a covenant running with a leasehold is that liability and enforcement of it are binding on subsequent transferees of the reversion or the leasehold interest even though such transferees did not expressly agree to assume any responsibility. In other words, if there is a covenant running with the land, it is unnecessary to establish privity of contract in order to enforce it; it is sufficient that the alleged obligor is in privity of estate with the party asserting the right.

Civil Code, Sec. 1460;

Stillwell Hotel Co. v. Anderson, 4 C.2d 463, 50 P.2d 441 (1935);

Bonetti v. Treat, 91 Cal. 223, 27 Pac. 612 (1891);

Los Angeles Term. Land Co. v. Muir, 136 Cal. 36, 68 Pac. 308 (1902);

Baker v. Maier & Zobelein Brewery, 140 Cal. 530, 74 Pac. 22 (1903);

14 *Cal. Jur.* 2d 17;

Burby, *Land Burdens in California—Covenants Running with the Land,* 4 So. Cal. L. Rev. 343 (1931).

Demonstrating the essentially contractual nature of covenants running with the land is the fact that the normal remedy for breach of such covenants is a judgment for damages. If this remedy is inadequate, equitable relief may be secured in accordance with the usual principles of contract law.

See:

Alderson v. Cutting, 163 Cal. 503, 126 Pac. 157 (1912);

Morgan v. Veach, 59 C.A.2d 682, 139 P.2d 976 (1943);

5 Restatement, Property, Secs. 528 and 529 (1944).

A covenant running with the land is essentially a contractual obligation with certain real property characteristics. Not one of the above authorities or cases suggests that a covenant running with the land creates a fiduciary duty. The practical effect of holding that a running covenant creates a fiduciary duty would be to convert every contract between a landlord and tenant into a fiduciary relationship inasmuch as the typical lease contains a covenant to pay rent or some other covenant which runs with the land.

Civil Code, Sec. 1464;

First Nat. Bank v. Aldridge, 33 C.A.2d 485, 92 P.2d 674 (1939);

Salisbury v. Shirley, 66 Cal. 223, 5 Pac. 104 (1884).

Inasmuch as a covenant running with land is essentially contractual, the breach of such a covenant immediately starts the running of the statute of limitations. The extreme proposition that a covenant running with the land creates a fiduciary duty which tolls the statute of limitations is totally unsubstantiated by reason and by authority.

D. A promise by Honolulu Oil Corporation or by any of its predecessors in interest to acknowledge an overriding royalty interest in Kennedy or his assigns in the event of an extension, modification or renewal of the lease does not create a fiduciary relationship which tolls the statute of limitations.

Appellees cite a series of cases on pages 14-17 of their brief such as *Probst v. Hughes,* 143 Okl. 11, 286 Pac. 875, 69 A.L.R. 929 (1930), and *Oldland v. Gray,* 179 F.2d 408 (10th Cir. 1950). These are decisions which establish a *constructive trust* as a method of equitable remedy *after* the breach of a promise to pay royalties in the event of extension, modification or renewal of an oil lease, that is, where there has been a refusal to recognize such royalty by one who has obtained an extension or renewal of the lease. Obviously, Honolulu or its predecessors have not breached any promise relative to the payment of royalties in the event of extension, modification or renewal of the leases here involved. Accordingly, the substantive relationship between the parties is still contractual, and is not affected by the fact that an equitable remedy might have been imposed had such a promise been broken.

Even if it be assumed arguendo that the promise to acknowledge Kennedy's royalty interest had been breached after an extension, modification or renewal of a lease, and even if it is assumed that such breach gives rise to a constructive trust, the availability of this equitable remedy does not create a fiduciary relationship which tolls the statute of limitations. See the above discussion concerning *Taylor v. Odell, supra.*

E. Any interest held by Kennedy was not in perpetuity, and did not import a cotenancy.

The leading case of *La Laguna Ranch Co. v. Dodge,* 18 C.2d 132, 114 P.2d 351 (1941), establishes that royalty interests created for the duration of a specific oil and gas lease would not be construed as creating a tenancy in common in a *profit a prendre,* in the absence of a clear indication that such was the intention of the parties. Appellees, having failed to point out any such indication, attempt to escape the mandate of the *La Laguna Ranch Co.* case by arguing that Kennedy's interest is "in perpetuity."

As to the lands here involved (the Kennedy lease lands) any interest Kennedy had under the pertinent agreements was not in perpetuity; it was necessarily limited to the duration of the leases and their renewals. As the California Supreme Court stated in *Dougherty v. California Kettleman,* 9 C.2d 58, 69 P.2d 155 (1937):

> "Obviously a royalty interest, such as is here involved, cannot rise to a greater dignity than the lease upon which it is predicated." (pp. 76-77)

La Laguna Ranch Co. v. Dodge, supra;
Smith v. Drake, 134 Cal.App. 700, 26 P.2d 313 (1933).

Certainly Kennedy's interest cannot be greater than the total interest which he held prior to the assignment to Honolulu's predecessors. Necessarily, Kennedy's rights were restricted to the duration of specific oil leases and their extensions, and are governed by the unequivocal principle of the *La Laguna Ranch Co.* case, which holds that such rights do not create a cotenancy relationship.

The fact that Kennedy's rights might be of indefinite duration if the permit and leases were extended does not alter this conclusion. Indeed the *La Laguna Ranch Co.* case involved a lease for an indefinite duration of five years and for so long thereafter as drilling operations were being conducted or oil and gas were being produced in paying quantities.

In brief, the promise to pay royalties to Kennedy was limited to the duration of specific leases and their renewals, and did not create a cotenancy under the controlling principle of the *La Laguna Ranch Co.* case.

F. There was no coadventure relationship between the parties to this action.

In our opening brief, the requisite elements of a coadventure were set forth on pages 35 and 36. Appellees in their answering brief did not attempt to show the essential elements of a coadventure, that is, a community of interest in the object of the undertaking, an equal right to direct or govern the conduct of the other parties, and a sharing of profits and losses. Thus, they have in effect abandoned any contention that a joint adventure existed.

CONCLUSION.

The question before this court is clear: Was there such a fiduciary relationship between these parties that the statute of limitations was tolled? The relationship between these parties was established by various documents which are subject to inferences and conclusions to be drawn by this court untrammeled by the prior determination of the District Court. None of these documents disclose a coadventure, a cotenancy or any other fiduciary relationship. Appellees have failed to demonstrate in what manner these documents differ from the usual, ordinary, every-day assignments, leases and other contracts in use in the oil industry, which it is conceded do not create fiduciary obligations.

The proposition that a fiduciary relationship existed between the parties to this action depends upon theories advocated by appellees which have no foundation either in reason or authority. Honolulu respectfully submits that the decision of the court below should be reversed.

Dated, San Francisco, California,
July 30, 1956.

HERBERT W. CLARK,
Attorney for Appellant
Honolulu Oil Corporation.

Of Counsel:

MORRISON, FOERSTER, HOLLOWAY,
SHUMAN & CLARK,
A. L. GIBSON,
H. M. DOWNS.